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THE INTELLECTUAL PROPERTY ANTITRUST PROTECTION ACT OF 1988

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Mr. BYRD (for Mr. BIDEN), from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 438, as amended]

The Committee on the Judiciary, to which was referred the bill (S. 438) to modify the application of the antitrust laws to encourage the licensing and other use of certain intellectual property, having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recommends that the bill (as amended) do pass.

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I. Purpose

The purpose of S. 438, as amended, are:

(1) to clarify the treatment of intellectual property rights under the antitrust laws by prohibiting courts from presuming the market power necessary for liability merely from the existence of a patent or copyright; and

(2) to reform the doctrine of patent misuse so it will not be used to restrict the rights of patent owners when their licensing practices do not violate the antitrust laws.

Innovation is a cornerstone of a strong American economy. One sure way to support innovation is to protect the fruits of creativity and invention. S. 438 is directed toward this goal. It will level the playing field so that intellectual property rights are treated in litigation the same as, not worse than, other property rights.

II. Legislative History

A. Title I—Elimination of Presumption of Market Power

Congress enacted the federal intellectual property laws pursuant to its constitutional power to promote the progress of science and useful arts. *See* U.S. Const. I, Sec. 8, cl. 8. The intellectual property laws increase social welfare by encouraging investment in innovation. By recognizing intellectual innovations as property, these laws provide inventors, as well as authors and other artists, with exclusive rights to the use of their inventions and original works for a limited time. These rights enable innovators to capture some of the economic rewards of their efforts.

The antitrust laws protect consumers and businesses by ensuring open and competitive markets. In preventing monopolists from illegally dominating or blocking access to markets, the antitrust laws also encourage innovation.

Many courts have presumed the requisite market power for antitrust liability merely from the existence of a patent or copyright. Commentators have disagreed with these court decisions, concluding that the legally enforceable property rights granted by our patent and copyright laws do not necessarily lead to monopoly control of economically relevant markets. The committee believes that the mistaken characterization of intellectual property rights as automatically granting meaningful economic power over a particular market has led to unnecessarily harsh treatment of patents and copyrights in some antitrust cases. Reform of the treatment of intellectual property under the antitrust laws is therefore necessary.

In *Digidyne Corp.* v. *Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985), for example, the Court of Appeals for the Ninth Circuit treated the defendant's refusal to license copyrighted computer software except to purchasers of its computer hardware as a per se unlawful tying arrangement. A tying arrangement is a form of package sale in which a seller conditions the sale or lease of one product (the tying product) upon the sale or lease of a second product (the tied product). Under certain circumstances, the antitrust laws condemn tying arrangements as per se unlawful. *See Jefferson Parish Hospital Dist. No. 2* v. *Hyde*,

466 U.S. 2 (1984) (stating the elements of per se illegal tying arrangements). Sufficient economic power in the tying product market to restrain appreciably competition in the tied product market is one of the elements of a per se unlawful tying arrangement.

The district court hearing the *Data General* case reversed a jury verdict in favor of the plaintiffs. The court concluded that the defendant lacked sufficient economic power in the software market for the tying arrangement to be illegal per se.

The ninth circuit reversed and reinstated the jury verdict in favor of the plaintiffs. The court found that the software system's copyright established the software's distinctiveness as a matter of law. It held that there was sufficient evidence from which the jury reasonably could have concluded that the software was sufficiently unique and desirable to an appreciable number of buyers to enable the defendant to force those consumers to buy the hardware. Thus, the tying arrangement was illegal per se.

The ninth circuit specifically rejected the lower court's market analysis which focused on functionally equivalent substitutes for the copyrighted software. It said that the existence of substitutes for the software was not relevant to whether sufficient economic power existed for an illegal tie-in:

> If a seller's product is distinctive, not available from other sources, and sufficiently attractive to some buyers to enable the seller by tying arrangements to foreclose a part of the market for a tied product, the adverse impact on competition in the tied product is not diminished by the fact that other sellers may be selling products similar to the tying product.

734 F.2d at 1345.

To the extent that this decision requires the plaintiff to establish that the defendant possesses economic power in the tying product market, it is unobjectionable. However, the decision can also be interpreted to mean that the existence of a copyright automatically leads to a presumption of economic power. The purpose of title I of S. 438, as amended, is to clarify that such a presumption is inappropriate.

Justice White, joined by Justice Blackmun, dissented from the Supreme Court's denial of *certiorari* in *Data General*. Although Justice White acknowledged the difficulties posed by a review of an appellate court's order reinstating a jury verdict vacated by the trial court, he stated:

> [T]his case raises several substantial questions of antitrust law and policy, including * * * what effect should be given to the existence of a copyright or other legal monopoly in determining market power.
>
> At stake is more than the resolution of this single controversy or even the clarification of what may seem at times to be a collection of arcane legal distinctions. In the highly competitive, multi-billion dollar a year computer industry, bundling of software and hardware, or of operating systems and central processing units, is somewhat common, and any differentiated product is especially attractive to some buyers. The reach of the decision in this case is potentially enormous, and as the United States

> strongly urges us to do, I would grant certiorari to address the substantial issues of federal law presented.

473 U.S. at 909.

The previous year, in 1984, a majority of the Supreme Court had asserted in dicta:

> [I]f the Government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power.

Jefferson Parish Hospital Dist. No. 2 v. *Hyde,* 466 U.S. 2, 16 (1984). This statement, coupled with the Supreme Court's *certiorari* denial in the *Data General* case, has sent a signal to intellectual property owners using package distribution schemes that they may be the target of antitrust suits relying on the presumption that patents or copyrights automatically confer market power.

Commentators have sharply criticized the presumption of sufficient market or monopoly power to warrant antitrust liability solely from the existence of a patent or copyright. For example, F. M. Scherer, professor of economics, Swarthmore College, has observed:

> A patented product may well be unique. It may, however, face a lot of substitutes, perhaps equally unique; and, as a result of this extensive availability of substitutes, confer very little, if any, monopoly power. Statistical studies suggest that the vast majority of all patents confer very little monopoly power—at least, they are not very profitable.

Panel Discussion, *The Value of Patents and Other Legally Protected Commercial Rights,* 53 Antitrust L.J. 535, 547 (1985).

Herbert Hovenkamp, law professor, University of Iowa, has stated:

> Many patents confer absolutely no market power in their owners, and often patented products are not even marketable at their cost of production. * * * The economic case for "presuming" sufficient market power to coerce consumer acceptance of an unwanted tied product simply because the tying product is patented [or] copyrighted * * * is very weak.

H. Hovenkamp, *Economics and Federal Antitrust Law,* Sec. 8.3 at 219 (1985).

Another commentator has noted:

> Patents and copyrights are sometimes quite valuable and give to their owner a degree of market power. More often than not, however, a patent or copyright provides little, if any, market power. Thus, the presumption of sufficient market power leading to a per se condemnation of a tying arrangement involving such products is unwarranted. * * * Tying arrangements involving patented or copyrighted products should be treated like other tying ar-

> rangements and should only be condemned upon a showing of actual economic power.

Note, *The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements,* 85 Colum. L. Rev. 1140, 1156 (1985).

The presumption of market power in antitrust cases involving patents or copyrights may inhibit the development and dissemination of technology. As a threshold matter, the threat of antitrust liability may act as a disincentive to the creation and distribution of new technology. However, even after a product has been developed and is enjoying public distribution, the possibility that a court will apply the presumption of market power may divert corporate resources toward litigation and away from vital research and development endeavors.

Responding to these concerns, Senators Leahy, Hatch, Thurmond and Humphrey introduced S. 438. Senators Baucus and DeConcini also cosponsored the bill. S. 438 has its genesis in the 98th Congress with the administration's National Productivity and Innovation Act, S. 1841, which was introduced by Senator Thurmond. That legislation would have applied the rule of reason to antitrust challenges to joint research and development ventures and to agreements licensing intellectual property rights. It also would have reformed the patent and copyright misuse doctrines and provided greater protection for process patents. Only the joint research and development provisions of that proposal were enacted in the National Cooperative Research Act of 1984, Public Law 98-462.

In the 99th Congress, Senators Hatch and Leahy introduced S. 2944. This legislation would have required that antitrust claims involving agreements to convey intellectual property rights be analyzed under a rule of reason standard and would have eliminated treble damage recoveries for antitrust claims involving these agreements. One of the bill's key objectives was to eliminate the presumption of market power in antitrust cases arising merely from the existence of a patent or copyright. Representative Hamilton Fish, Jr., had previously introduced legislation comparable to S. 2944 in the House of Representatives as H.R. 4070.

In the 100th Congress, Congressman Fish introduced a bill similar to S. 438. Hearings on the Fish bill, H.R. 557, were held before the Subcommittee on Monopolies and Commercial Law of the House Judiciary Committee on April 30, 1987.

On October 20, 1987, the Senate Subcommittee on Technology and the Law, and Antitrust, Monopolies and Business Rights held a joint hearing on S. 438. Testifying at the Joint hearing were: Congressman Fish; Sanford Feman, Esq., for the Hewlett-Packard Co.; Prof. Carl Shapiro of the Woodrow Wilson School, Princeton University; Robert P. Taylor, Esq., for the American Bar Association; Jack E. Brown, Esq., of Brown & Bain, Phoenix, AZ; and Thomas M. Susman, Esq., for Digital Equipment Corp.

In his opening remarks at the joint subcommittee hearing, Senator Leahy observed that as a result of the discriminatory treatment accorded patents and copyrights in some antitrust cases,

> American businesses may be forced to avoid agreements that would permit them to cut costs by developing efficient

> distribution schemes for functionally related products * * *. In some cases, the threat of antitrust liability even deters American companies from developing new technology.

Intellectual Property Antitrust Protection Act, 1987: Hearings on S. 438 before the Subcommittees on Technology and the Law and Antitrust, Monopolies and Business Rights of the Senate Committee on the Judiciary, 100th Cong., 1st Sess. (1987).

In his statement when the bill was introduced, Senator Hatch stated:

> Some recent judicial decisions have created uncertainty in the high-technology community by invalidating licensing practices which do not have anticompetitive consequences * * *. The proposed legislation would send a reliable signal to the courts and the business community that would encourage, rather than discourage, technological innovation.

133 Cong. Rec. S 1597 (Feb. 3, 1987).

Congressman Fish testified in support of H.R. 557 and S. 438 at the joint hearing. With respect to the presumption that a patent or copyright creates market power, Congressman Fish concluded:

> [T]raditional antitrust analysis of intellectual property licensing agreements has increasingly become outdated in a high-technology setting. * * * The presumption of market power, as it has been frequently applied in the courts to licenses involving intellectual property, is simply bad law and should be overturned.

Mr. Sanford Feman of the Hewlett-Packard Company's Medical Products Group used a heart monitoring system to support his testimony concerning the harm caused by the antitrust laws' current treatment of copyrighted products. To control quality and prevent malfunctions caused by use of the heart monitor's components with other manufacturers' equipment, Hewlett-Packard sells the heart monitor's hardware and copyrighted software together as a system. According to Mr. Feman, however, the *Data General* decision could require Hewlett-Packard to separate the components of the monitoring system:

> We are going to tell [company managers], for example, that the software and the hardware on this [heart monitor] should be treated by the courts like a mattress and a bed—you have to be able to sell one without the other. * * * We think that would be bad for competition, bad for health care providers, bad for health care recipients, and bad for manufacturers.

Referring to the heart monitor, Carl Shapiro, professor of economics and public affairs at Princeton University, also testified about harm to consumers caused by the current treatment of intellectual property licensing agreements:

> There are a variety of beneficial effects of licensing that are in the interest of consumers, and some of these desirable licensing arrangements, such as that described here, are being prohibited under the current treatment of the law.

Mr. Robert Taylor, representing the American Bar Association, agreed that the presumption of market power penalized intellectual property owners:

> The problem that you have in the area where the tying product is a patented process or a patented article or is a copyright is the courts say that they simply are going to foreclose the plaintiff from any need to prove market power. So you end up with a circumstance where the ability of a licensor to commercialize his product is simply not there.

Mr. Thomas M. Susman, representing Digital Equipment Corp., also criticized the presumption of market power in antitrust cases. Mr. Susman commented:

> Mere ownership of a patent or copyright does not convey market power. There may be no demand for the patented or copyrighted product. Or, there may be substitutable products on the market; the ability of the owner of the patented or copyrighted product to raise prices above a competitive level is limited by the existence of these substitutes. Yet, even in these circumstances, current law provides that market power sufficient to find an antitrust violation will be presumed. This should be changed by Congress.

In their testimony, Mr. Taylor and Mr. Susman also emphasized the need for reforming the patent misuse doctrine, which bars a patent owner from asserting a patent infringement claim if the owner has tried to extend his patent grant beyond its statutory limits. Title II of S. 438, as amended, addresses patent misuse reform.

The committee is aware that many in the high-technology industry, particularly companies that market innovative products like computer systems, continue to believe that legislation is needed which not only addresses the market power presumption, but also applies an approach different from traditional tying analysis to arrangements involving technologically integrated products. Manufacturers often integrate and sell technologically related products together to be used as a system. The integration of these technologically related products, it is argued, is designed to provide a complete solution to a customer's problem, or to assure efficient operation. Some courts have applied traditional antitrust tying analysis to these products. Such analysis can lead, these companies argue, to a requirement that certain copyrighted software, and other integrated portions of a computer system in which the software performs, must be sold separately from that system. *See Digidyne Corp.* v. *Data General Corp.*, 734 F.2d 1336 (9th Cir. 1948), *cert. denied,* 473 U.S. 908 (1985). *But see A.I. Root Co.* v. *Computer/Dynamics, Inc.*, 806 F.2d 673 (6th Cir. 1986); *Will* v. *Comprehensive Ac-*

counting Corp., 776 F.2d 665 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 1659 (1986).

B. TITLE II—PATENT MISUSE REFORM

Legislation was first introduced in the 98th Congress (S. 1841, title IV) to reform the patent misuse doctrine as part of the administration's National Productivity and Innovation Act. Hearings on the bill reflected extensive support of and no opposition to title IV: the chairman of the ABA Patent Law Section, the president of Intellectual Property Owners, Inc., and the president of the American Intellectual Property Law Association supported enactment of title, IV. Patent Law Improvements Act, 1984, Hearings on S. 1535 and S. 1834 before the Senate Committee on the Judiciary, 98th Congress, 2d Sess. 44, 52, 91, 105 (1984). However, concern over the specific language of the proposal was expressed and, ultimately, the Congress went on to approve and enact only title I of the bill as the National Cooperative Research Act of 1984 (the so-called "Joint R&D Venture Bill"), Public Law 98-462.

In the 100th Congress legislation was again introduced to reform the law of patent misuses. S. 635, Section 115, 100th Congress, 1st Sess. General patent law oversight hearings were held by the Subcommittee on Patents, Copyrights and Trademarks, and testimony received during those hearings again supported enactment of patent misuse reform legislation.

In a statement submitted by Ronald T. Reiling on behalf of Digital Equipment Corporation, Reiling highlights the need for misuse legislation in the current technological age:

> These misuse doctrines are inappropriate to this era when intellectual property rights are essential components of technological and economic growth and international competitiveness. The currernt misuse doctrines hinder development and distribution of technological advances by requiring only that a court find "some" anticompetitive effect.

Reiling's observations are echoed in a statement submitted to the Subcommittee on Patents, Copyrights and Trademarks by Robert Kline, president of the American Intellectual Property Law Association. In a letter dated June 4, 1987, Kline outlines the AIPLA concerns with the current doctrine:

> The "misuse" doctrine is a counterproductive legal fiction. It negatively affects virtually every license agreement involving technology developed or used in the United States. The doctrine reduces the incentive to innovate. This doctrine does not increase or stimulate competition.

Kline continues by detailing improvements in S. 1200:

> S. 1200 is a clear and straightforward solution to the "patent misuse" problem. It would merely require and ensure that economic analysis has been conducted before a court would be able, properly, to refuse to enforce a valid patent on anti-competitive grounds.

During subcommittee consideration of S. 635, a proposal was made to change the language listing specific conduct by patent owners to which the law would apply to a more generic and easily applied approch that had been recommended on earlier testimony by the AIPLA witness. Chairman DeConcini adopted this amended language in an original bill circulated to the subcommittee, and, on May 13, 1987, the Subcommittee on Patents, copyrights and Trademarks unanimously approved that bill, containing the present title II on reform of the misuse doctrine. This original bill was then introduced by Chairman DeConcini on May 14, 1987, as S. 1200. See Cong. Rec. S 6480–86 (May 14, 1987, daily ed.)

The Committee on the Judiciary met and considered the bill on June 4, 1987, and voted favorably to report the legislation. The committee intended by adoption of this bill to clarify the law of patent misuse and to put intellectual property rights on an equal footing with other property with respect to the license, sale and other agreements concerning the distribution of property rights.

The Senate incorporated S. 1200 into its trade bill, S. 1420. The House trade bill, H.R. 3, did not contain a provision addressing patent misuse, nor had the House held hearings to study patent misuse. *See* Conference Report, H.R. 3, Omnibus Trade and Competitiveness Act of 1988, H.R. Rpt. No. 576, 100th Cong., 2nd Sess. 1091 (1988). On May 11, 1988, the Subcommittee on Courts, Civil Liberties, and the Administration of Justice of the House Judiciary Committee held a hearing on patent misuse legislation, focusing on title II of S. 1200 and H.R. 4086, a bill introduced by Representative Robert Kastenmeier.

During its consideration of S. 438, the Senate Judiciary Committee included title II of S. 1200 in the amendment in the nature of a substitute to S. 438. Both titles of S. 438 have the purpose of eliminating unfair penalties placed by courts on intellectual property owners based on outdated and erroneous judicial doctrines.

III. Discussion

S. 438, as amended, addresses the presumption of market power arising from a patent or copyright and the patent misuse doctrine. Both the presumption and the misuse doctrine punish innovators engaged in procompetitive distribution and licensing practices.

A. TITLE I—ELIMINATION OF PRESUMPTION OF MARKET POWER

1. Development and status of the presumption

The Supreme Court formulated the presumption of market power in antitrust cases involving patented and copyrighted products. The presumption evolved from the Supreme Court's patent misuse doctrine, which bars a patent owner from asserting a patent infringement claim if the owner has tried to extend his patent grant beyond its statutory limits. Early examples of misuse were trying arrangements. *See Morton Salt Co.* v. *G.S. Suppiger Co.,* 314 U.S. 488 (1942); *Motion Picture Patents Co.* v. *Universal Film Manufacturing Co.,* 243 U.S. 502 (1917).

The Supreme Court first applied the policy underlying the patent misuse doctrine to an antitrust context in *International Salt Co.* v. *United States,* 332 U.S. 392 (1947). There, the defendant leased pat-

ented salt processing machines to various processors on the condition that the processors also purchase their salt from the defendant. The Court found that the defendant had unlawfully extended its patent rights in the salt processing machines to restrain competition in salt. In support of its holding, the Court noted that the "patents confer a limited monopoly of the invention they reward. * * * But the patents confer no right to restrain use of, or trade in, unpatented salt." *Id.* at 395–96. One year later, in *United States* v. *Paramount Pictures, Inc.*, 334 U.S. 131 (1948), the Supreme Court extented *International Salt's* patent misuse rationale to copyrighted products. It viewed the distribution of copyrighted motion pictures on the condition that exhibitors accept uncopyrighted or less desirable films, a practice known as "block-booking," as an unlawful attempt by the copyright holder to extend its copyright monopoly to uncopyrighted products. The Court held that tying the licensing of certain copyrighted feature films to other films was per se illegal.

The Supreme Court first expressly articulated the market power presumption when it revisited the practice of "block-booking" motion pictures in *United States* v. *Loew's Inc.*, 371 U.S. 38 (1962). In the intervening 14 years since the *Paramount Pictures* decision, the Court expressly began requiring that the defendant have sufficient economic power in the market for the tying product before condemning a tying arrangement as illegal per se. *See e.g., Northern Pacific Railway* v. *United States,* 356 U.S. 1 (1958). The Court in *Loew's* could no longer rely exclusively on the policy of the misuse doctrine as the rationale for condemning the block-booking arrangement. Instead, the Court focused on the importance of the seller's economic power in the tying product market and held that such power "is presumed when the tying product is patented or copyrighted." 371 U.S. at 45. Observing that a product's uniqueness may confer the kind of economic leverage which will enable a seller to enforce an unlawful tying arrangement, the Court reasoned that "[s]ince one of the objectives of the patent laws is to reward uniqueness, * * * the existence of a valid patent on the tying product, without more, establishes a distinctiveness sufficient to conclude that *any* tying arrangement involving the patented product would have anticompetitive consequences." *Id.* at 46 (emphasis added). Asserting that *Paramount Pictures* had extended this reasoning to copyrighted films, the Court found the block-booking contracts in *Loew's* to be per se unlawful.

The Supreme Court has reiterated the presumption of market power in dicta in its tying arrangement cases, most recently in *Jefferson Parish Hospital Dist. No. 2* v. *Hyde,* 466 U.S. 2, 16 (1984). However, in a concurring opinion, Justice O'Connor, joined by three other Justices, challenged the rationale underlying the presumption, stating:

> A common misconception has been that a patent or copyright, a high market share, or a unique product that competitors are not able to offer suffice to demonstrate market power. While each of these three factors might help to give market power * * * a patent holder has no

> market power in any relevant sense if there are close substitutes for the patented product.

Id. at 37, n. 7 (O'Connor, J., concurring).

Lower courts have split in three directions on whether the requisite market power to support antitrust liability is actually conferred by the existence of a patent or copyright. While some courts have accepted the presumption as conclusive evidence of sufficient market power to support a finding of antitrust liability, other courts have suggested that the presumption raises a rebuttable inference of the patent or copyright holder's market power. Recently, a few courts have stated that a patent or copyright does not necessarily confer market power and have declined to rely on the presumption in determining whether a tying arrangement involving a patent or copyright constitutes a per se violation of the antitrust laws.

Those courts adhering to the *Loew's* decision have accepted the proposition that the existence of a patent or copyright conclusively establishes the requisite economic power to enable a patent or copyright holder to unlawfully coerce a consumer into accepting other products. *See, e.g., Hazeltine Research* v. *Zenith Radio Corp.,* 239 F. Supp. 51 (N.D. Ill. 1965), *aff'd,* 388 F.2d 25 (7th Cir. 1967), *aff'd in part and rev'd in part,* 395 U.S. 100 (1969); *Duplan Corp.* v. *Deering Milliken, Inc.,* 444 F. Supp. 648 (D.S.C. 1977), *aff'd in part and rev'd in part,* 594 F.2d 979 (4th Cir. 1979), *cert. denied,* 444 U.S. 1015 (1980).

Without addressing the appropriateness of the presumption, other courts have suggested that the presumption is rebuttable and that it shifts the burden of persuasion to the defendant to establish that the "presumed" market power does not exist. *See Digidyne Corp.* v. *Data General Corp.,* 734 F.2d 1336 (9th Cir. 1984), *cert. denied,* 473 U.S. 908 (1985). However, the ninth circuit's approach, which does not permit consideration of evidence relating to the availability of substitutes, may suggest that a patent or copyright holder will never be able to rebut the presumption. Title I of S. 438, as amended, precludes this approach.

A few jurisdictions have recently rejected the presumption in favor of an analysis of the patent or copyright holder's actual market power with respect to the patented or copyrighted product. In *A.I. Root Co.* v. *Computer/Dynamics, Inc.,* 806 F.2d 673 (6th Cir. 1986), the Court of Appeals for the Sixth Circuit considered the legality of an arrangement whereby a manufacturer of small business computers and copyrighted software conditioned the software's sale on its use with the manufacturer's computers and the licensing of other software. The manufacturer controlled only 2–4 percent of the small computer market. In rejecting the *Loew's* presumption and finding that the licensing practice did not constitute per se liability under the antitrust laws, the sixth circuit characterized the pronouncement in *Loew's* as "overbroad and inapposite to the instant case." *Id.* at 676. In support of its holding, the sixth circuit observed that " '[m]ore often than not * * * a patent or copyright provides little, if any, market power.' " *Id.* (quoting Note, *The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements,* 85 Colum. L. Rev. 1140, 1156 (1985)).

In *Nobel Scientific Industries* v. *Beckman Instruments,* 670 F. Supp. 1313 (D. Md. 1986), *aff'd,* 831 F.2d 537 (4th Cir. 1987), the district court similarly rejected the proposition that the existence of a patent automatically establishes sufficient market power for antitrust liability. There, the court considered the legality of a tying arrangement involving machinery which incorporated various patented parts. After evaluating actual market conditions which revealed the availability of substitutes for the machinery as well as its patented parts, the court determined that the arrangement was not a per se unlawful tie-in. *Id.* at 1328–29.

2. Need for elimination of the presumption

Although patents and copyrights constitute legally enforceable property rights, they do not in and of themselves necessarily constitute economic monopolies. Similarly, although the "uniqueness" or "distinctiveness" of a particular product may be essential to the award of a patent or copyright, the patent or copyright does not necessarily result in economic power when evaluated under standard antitrust principles.

The application of the presumption of market power forecloses a court's consideration of factors that the court would consider relevant in antitrust cases involving a nonpatented or noncopyrighted product. For example, it prevents courts from considering whether there are substitute products for a patented product used in a tying arrangement. Thus, in some cases the presumption has penalized intellectual property owners. The presumption also may increase the likelihood that antitrust claims will be brought against patent and copyright owners who should not be subject to antitrust liability. In short, the undesirable economic result may be the hindrance of the development and dissemination of innovative technology.

By eliminating the presumption of market power in antitrust cases involving patents, copyrights and mask works (semiconductor chip designs), the committee does not sanction anticompetitive arrangements for the distribution of, or refusal to distribute, intellectual property rights and innovative products.

S. 438 eliminates the presumption of market power. The existence of an intellectural property right, along with other evidence concerning the distribution of such a right or product protected by such a right, will still be relevant to the determination of market definition, market power or monopoly power. The elimination of the presumption will simply require plaintiffs to assume their proper burden of proof in antitrust cases involving intellectual property. It will require only that courts evaluate practices involving intellectual property rights under the same antitrust principles that are applied to practices involving other forms of property.

In the case of a tying arrangement, where the elements of a per se unlawful tie have been factually proven, the intellectual property owner will remain subject to per se liability to the same extent as owners of other forms of property. The elements of a per se unlawful tying arrangement include actual proof of market power.

The committee determined that it was not necessary to include trademarks in the bill's definition of intellectual property rights. The owner of a trademark has the exclusive right to use the mark in connection with its products. Because they protect only a pro-

ducer's business name, the rights associated with a trademark are typically narrower than those that attach to a patent, copyright or mask work.

The committee also determined that it was not necessary for the bill to cover trade secrets, which are governed primarily by State, not federal, law. A trade secret protects a proprietor against wrongful approrpriation of commercially advantageous information only as long as he or she keeps it secret. Competitors are free to develop their own trade secrets. The committee is not aware of any court that has concluded that a trade secret raises a presumption of market power. *Cf. In re Data General Corp. Antitrust Litigation,* 490 F. Supp. 1089, 1113–14 (N.D. Cal. 1980), *aff'd in part,* 734 F.2d 1336 (9th Cir. 1984), *cert. denied,* 473 U.S. 908 (1985) ("it has never been held that trade secret protection is sufficient to create presumption of economic power").

The committee does not intend to change current law relating to whether a trade secret or a trademark, standing alone, creates a presumption of market power.

B. TITLE II—PATENT MISUSE REFORM

The doctrine of patent misuse is a judicially created doctrine. It constitutes a defense to a patent infringement suit and provides that a patent owner may not enforce its patents if it has engaged in conduct deemed "misuse," at least until the patentee's conduct constituting misuse has ceased and its effects purged. Misuse thus renders the patent unenforceable, not void.

One branch of the misuse doctrine involves conduct alleged to constitute fraud on or inequitable conduct before the Patent Office. This part of the doctrine remains unaffected by title II.

The second branch of the misuse doctrine, to which this legislation is addressed, has its root in judicial interpretations that find misuse present because of alleged anticompetitive extensions of the owner's patent rights. For example, while misuse may be found where the antitrust laws have been violated, it may also be found where the patent owner's conduct has not violated the antitrust laws, has no demonstrated anticompetitive effect and has not even injured the infringing party who raises misuse as a defense.

In recent years the need for reform of the law of patent misuse has gained increasing recognition. Commentators have repeatedly criticized the doctrine and reform was initially proposed in title IV of S. 1841, the National Productivity and Innovation Act, introduced by Senator Thurmond in the 98th Congress. Hearings on this earlier proposal revealed extensive support for reform of the patent misuse doctrine.

In 1984 hearings before the Subcommittee on Patents, Copyrights and Trademarks, Bernarr R. Pravel of the American Intellectual Property Law Association (AIPLA) testified that reform of the law of patent misuse would encourage and promote the efficient use of newly created technology. Mr. Pravel stated:

> Very often, the creators and owners of advances in technology in the form of intellectual property are not able to fully develop its commercial applications. In these cases, the most effective, and often the only, method of bringing

> this technology to the market place is for its owner to license it to another with the ability to do so. However, despite the practical benefits of licensing to the industrial innovation process, courts have sometimes found intellectual property licensing practices to be unlawful without fully considering the effect of the practices on competition.

Recent statements by the U.S. Department of Justice and American Bar Association Section of Antitrust Law also emphasize the need for reform. In a letter to the Subcommittee on Patents, Copyrights and Trademarks dated June 4, 1987, John R. Bolton, Assistant Attorney General of the U.S. Department of Justice, stated that:

> The Department believes that legislation in the misuse area is both important and timely, and thus strongly supports this legislation. Because the sanction of misuse is harsh * * * patent owners can be expected to avoid entering into patent licensing arrangements that they fear may be deemed to constitute patent misuse. In order to reassure creators of new technology that the courts will not interfere with procompetitive patent licensing, the misuse doctrine must not be applied in a manner that condemns competitively desirable licensing.

Robert P. Taylor of the American Bar Association Section of Antitrust Law stated in a letter to the Subcommittee on Patents Copyrights and Trademarks of May 11, 1987, that:

> This change is needed to promote and encourage the licensing of new technology. In many situations, the misuse doctrine in its present form forces the owner of new technology to choose between either not licensing at all or licensing under circumstances which place at risk the enforceability of this property and contractual rights to that technology. * * * It also means that creative and innovative licensing schemes are rarely if ever used, because any license provision that is even slightly questionable is likely to place the entire patent at risk whenever an enforcement proceeding is brought.

Some courts have themselves questioned the soundness of the patent misuse doctine. The Justice Department also has urged its reform: Deputy Assistant Attorney General Roger Andewelt articulated a firm foundation for concluding that the misuse doctrine has been applied in a manner inconsistent with sound economic principles in his speech before the Bar Association for the District of Columbia on November 3, 1982. And recent law review commentary has condemned certain applications of the misuse doctrine as inherently anticompetitive. 46 U. Pitts. L. Rev. 209 (1984).

The lack of clarity and predictability in application of the patent misuse doctrine and that doctrine's potential for impeding procompetitive arrangements are major causes for concern. Title II addresses this concern by providing that conduct shall only be found to be misuse when that conduct violates the antitrust laws. As Donald W. Banner of the organization Intellectual Property Owners, Inc., observed in his 984 testimony before the Subcommit-

tee on Patents, Copyrights and Trademarks, the proposed reform would "add predictability to the law governing licensing practices" and "eliminate a hodgepodge of arbitrary rules developed by courts during the era when courts were hostile to licensing." Mr. Banner continued: "By providing more certainty to the permissible scope of licensing practices, the bill would increase the value of patents to patent owners. This would strengthen the incentives that patents provide to engage in research and development."

ORIGIN AND DEVELOPMENT OF THE PATENT MISUSE DOCTRINE

Patent misuse is a judicially created doctrine that allows a patent owner's overextension of his or her patent rights to be asserted as a defense in an action by the patent owner to enforce the patent. If the patent owner is held to have overextended, or "misused" patent rights, equity may bar the owner from enforcing the patent as long as the misuse continues. *Morton Salt Co.* v. *G.S. Suppiger Co.,* 314 U.S. 488 (1942).

The doctrine of patent misuse originally emerged as a judicial response to the patent owner's practice of conditioning the sale or license of patented inventions upon the purchase or license of additional products. This practice was at first approved by courts, including the United States Supreme Court. In *Henry* v. *A.B. Dick Co.,* 224 U.S. 1 (1912), the Court upheld a patent owner's practice of requiring, as a condition to sale of a patented invention (memeograph machine), that the invention be used only with certain supplies (ink) provided by the patent owner.

By 1917, however, the Court's attitude had changed. Citing the enactment of Section 3 of the Clayton Act as evidence that such conditional sales were against public policy, the Court held that the conditions to sale were unenforceable regardless of whether they violated the Clayton Act. In *Motion Picture Patents Co.* v. *Universal Film Manufacturing Co.,* 243 U.S. 502 (1917), the owner of a patent for a film feeder used in the projection of motion pictures sought to license the feeder on the condition that the licensee show only films leased from persons approved by the patent owner. The patented film feeder was dramatically superior to other film feeders on the market, giving the patent owner significant market power. The Court refused to enforce the patent, finding that imposing the condition would extend the patent owner's power beyond the scope of its patent rights. *Id.* at 518.

Cases following *Motion Picture Patents* continued to expand the doctrine of patent misuse. In the *Morton Salt Co.* case, where the term "patent misuse" appears for the first time, the Supreme Court held that the misuse defense was available even to a person who knowingly infringed a valid patent and was not affected by the conduct held to be misuse. The patent owner in *Morton Salt* had licensed its patented salt machine upon the condition that the licensee use the machine with salt tablets purchased from the patent owner. According to the Court, this use of the patent exceeded the limited grant of the Patent Act, the patent owner had misused the patent, and the owner therefore was not entitled to the protection of the Act. 314 U.S. at 491. The Court found it unnecessary to de-

termine whether the patent owner's action had violated the antitrust laws. 314 U.S. at 494.

In *Morton Salt,* as in *Motion Picture Patents,* the Court ignored the antitrust issues presented and based its decision on public policy grounds. From this origin courts have developed the principle that a claim of patent misuse need not be supported by a showing of violation of the antitrust laws. *See, e.g., Zenith Radio Corp.* v. *Hazeltine Research, Inc.,* 395 U.S. 100, 140–41 (1960); *Duplan Corp.* v. *Deering Milliken, Inc.,* 444 F. Supp. 648 (D.S.C. 1977), *affd* in relevant part, 594 F.2d 979 (4th Cir. 1979). In most courts, the *Morton Salt* principles, interpreted as they were in *Zenith Radio* and *Duplan,* remain the established law of patent misuse. See Section of Antitrust Law of the American Bar Association, Antitrust Law Developments (2d) 488–89 (1984), and cases cited therein.

Recently, however, the seventh circuit challenged the reasoning of *Motion Picture Patents, Morton Salt,* and the line of cases following these decisions. In *USM Corporation* v. *SPS Technologies, Inc., 694 F.2d 505 (7th Cir. 1982), cert. denied,* 462 U.S. 1107 (1983), the court of appeals, in dicta, questioned whether the reasoning of *Motion Picture Patents* accurately characterized the economic effect of practices held to constitute patent misuse. At issue in *USM Corporation* was whether the inclusion of a different royalty schedule in a license agreement constitutes patent misuse. Citing the facts of several prior findings of patent misuse, including *Brulotte* v. *Thys Co.,* 379 U.S. 29 (1964) (patent license extending licensee fees beyond license period), *Zenith Radio Corp.* v. *Hazeltine Research, Inc.,* 395 U.S. 100, 133–40 (1969) (patent royalties measured by the sale of unpatented products containing the patented item), and *Steward* v. *Mo-Trim, Inc.,* 192, U.S.P.Q. 410 (S.D. Ohio 1975) (licensees required not to make items competing with the patented item), Judge Posner noted that:

> As an original matter one might question whether any of these practices really "extends" the patent. The patentee who insists on limiting the freedom of his purchaser or licensee * * * will have to compensate the purchaser for the restriction by charging a lower price for the use of the patent. * * * True, a tie-in can be a method of price discrimination. It enables the patent owner to vary the amount he charges for the use of the patent by the intensity of each user's demand for the patent. * * * But since * * * there is no principle that patent owners may not engage in price discrimination, it is unclear when one form of discrimination, the tie-in, alone is forbidden.

Id. at 510–11.

In addition, the *USM Corporation* court questioned the appropriateness of the low showing of anticompetitive effect required to establish patent misuse. The court suggested that patent misuse claims could be tested under standard antitrust principles, stating that, "Our law is not rich in alternative concepts of monopolistic abuse and it is rather late in the day to try to develop one without in the process subjecting the rights of patent holders to debilitating uncertainty." *Id.* at 512.

IV. Vote of the Committee

On July 28, 1988, S. 438 was reported favorably by poll from both the Subcommittee on Technology and the Law and the Subcommittee on Antitrust, Monopolies and Business Rights. On August 3, 1988, with a quorum present, by voice vote, the committee approved an amendment in the nature of a substitute cosponsored by Senators Leahy, Hatch, Thurmond, DeConcini, Kennedy, Humphrey and Metzenbaum and unanimously ordered the bill (as amended) favorably reported.

V. Text of S. 438, as Amended

[S. 438, 100th Cong., 1st Sess.]

A BILL To modify the application of the antitrust laws to encourage the licensing and other use of certain intellectual property.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I—INTELLECTUAL PROPERTY

Sec. 101. This title may be cited as the "Intellectual Property Antitrust Protection Act of 1988".

PROHIBITION OF MARKET POWER PRESUMPTION

Sec. 102. In any action in which the conduct of an owner, licensor, licensee, or other holder of an intellectual property right is alleged to be in violation of the antitrust laws in connection with the marketing or distribution of a product or service protected by such a right, such right shall not be presumed to define a market or to establish market power, including economic power and product uniqueness or distinctiveness, or monopoly power.

Sec. 103. For purposes of this title—

(1) the term "antitrust laws" has the meaning given it in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)); and

(2) the term "intellectual property right" means a right, title, or interest—

(A) in subject matter patented under title 35 of the United States Code, or

(B) in a work, including a mask work, protected under title 17 of the United States Code.

TITLE II—PATENT MISUSE DOCTRINE REFORM

Sec. 201. Section 271 of title 35, United States Code, is amended—

(1) by redesignating subsection (c) as paragraph (1) of subsection (c);

(2) by redesignating subsection (d) as paragraph (2) of such subsection (c); and

(3) by inserting after subsection (c) the following new subsection:

(d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or

deemed guilty of misuse or illegal extension of the patent right by reason of his or her licensing practices or actions or inactions relating to his or her patent, unless such practices or actions or inactions, in view of the circumstances in which such practices or actions or inactions are employed, violate the antitrust laws.

VI. Section-by-Section Analysis

Section 101

This title, when enacted, may be cited as the "Intellectual Property Antitrust Protection Act of 1988."

Section 102

This section provides that an intellectual property right shall not be presumed to define a market, or establish market power or monopoly power, in any action in which the owner, licensor, licensee or other holder of an intellectual property right is alleged to be in violation of the antitrust laws in connection with the marketing or distribution of a product or service protected by such a right.

The term "intellectual property right" is defined in Section 103 to cover patents, copyrights and mask works.

The references to "owner," "licensor," "licensee" and "holder" of an intellectual property right recognizes the different formulations given to a person or entity with a right, title or interest in intellectual property. For example, courts usually refer to someone with an interest in a patent as either an owner, licensor or licensee. Copyright law uses the term "holder" of rights. The listing of the different terms is intended to ensure that title I will cover both sides of transactions involving intellectual property.

The reference to antitrust actions challenging conduct "in connection with the marketing or distribution of a product or service protected by such a right" is intended to apply to any antitrust action challenging the legality of the defendant's conduct involving the marketing or distribution of an intellectual property right. In the case of a patent, for example, this would include the sale of patented products, the licensing of, or refusal to license, patent rights, and the enforcement of patent rights through legal action.

In describing the power that a defendant must have in the marketplace to be liable under the antitrust laws, courts have used, sometimes interchangeably, the following terms: market power, monopoly power, economic power and product uniqueness or distinctiveness. *See, e.g., Jefferson Parish Hospital Dist. No. 2* v. *Hyde,* 466 U.S. 2, 13–14 (1984) (market power); *U.S.* v. *Loew's, Inc.,* 371 U.S. 38, 45–49 (1962) (economic power and product uniqueness or distinctiveness); *International Distribution Centers, Inc.* v. *Walsh Trucking Co.,* 812 F.2d 786, 791 n.3 (2d Cir. 1987) (Market power is a "synonym" for monopoly power); *Consolidated Gas Co. of Florida* v. *City Gas Co. of Florida,* 665 F. Supp. 1493 (S.D. Fla. 1987) (economic power, monopoly power and market power). The inclusion of all of these terms in title I is intended to ensure that the bill's remedial goal will not be frustrated by the use of a description other than "market power" for the type of power that gives rise to antitrust liability.

Section 103

Subsection (1) incorporates by reference the definition of the term "antitrust laws" used in subsection (a) of the first section of the Clayton Act, 15 U.S.C. Sec. 12(a).

Subsection (2) defines the term "intellectual property right" to mean a right, title or interest in a patent, copyright or mask work. Although the patent and copyright laws use the term "right" to refer to a person's property interest in these forms of intellectual property, courts also use the terms "title" or "interest." For example, a licensee's bundle of rights in a patent is often referred to as an "interest." By including the terms "right," "title" or "interest," the committee intends to cover all possible property interests in the intellectual property rights listed in title I of the bill.

Title 35 and title 17 of the United States Code govern the subject matters protected by a patent or copyright, respectively. Chapter 9 of title 17, added in 1984, protects semiconductor chip designs, known as mask works. Although the committee was not aware of any cases in which a court had presumed market power from the existence of a mask work protected under title 17, there has been little time for judicial development under this new law. The committee was concerned that, with more time, courts might extend the presumption to mask works as they had already done to copyrights. This could cripple important sectors of our high-technology industry.

Section 201

Subsections (1) and (2) provide for conforming changes to Section 271 of title 35, United States Code. Subsection (3) provides for the addition of language to Section 271 addressing patent misuse. This language provides that no patent owner shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his or her licensing practices, actions or inactions relating to his or her patent, unless such conduct violates the antitrust laws. The phrase "otherwise entitled to relief" makes clear that the committee does not intend to affect existing law relating to fraud on the patent office.

The term "patent owner" is intended to include all persons with the rights commonly held by a patent owner, including a licensee of a patent who is engaged in the sublicensing of the patent.

Title II includes contributory infringement as well as infringement to make clear that a party charged with contributory infringement under 35 U.S.C. § 271(c) must also show conduct violating the antitrust laws to support the affirmative defense of patent misuse.

The reference to "illegal extension of the patent right" as well as "misuse" recognizes the differing formulations of activity deemed to be "misuse" and that misuse is often characterized as illegal extension of the patent right. Such reference to "illegal extension" is not meant, by itself, to alter or expand in any way the existing law of patent misuse.

The terms "licensing practices," "actions" and "inactions" are intended to include omissions as well as affirmative acts. The refus-

al to license or failure to take action is intended to be included within the meaning of "licensing practices or actions or inactions."

The broad reference to the patent owner's "actions or inactions relating to his or her patent"—in addition to "licensing practices"—indicates that the provisions of the subsection are not limited in application to licensing practices, but extend to all actions taken by the patent owner with respect to his patent, including the sale of patented products as well as the license of patent rights. The phrase "actions or inactions relating to his or her patent" includes the patent owner's sale of a product that embodies the patent.

VII. Cost Estimate

In accordance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate and Section 403 of the Congressional Budget Act of 1974, the committee provides the following cost estimate, prepared by the Congressional Budget Office:

U.S. Congress,
Congressional Budget Office,
Washington, DC, August 8, 1988.

Hon. Joseph R. Biden, Jr.,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has reviewed S. 438, the Intellectual Property Antitrust Protection Act of 1988, as ordered reported by the Senate Committee on the Judiciary, August 3, 1988. We expect that enactment of the bill would result in no cost to the federal government or to state or local governments.

S. 438 would modify the application of antitrust laws in order to encourage the licensing of intellectual property. Specifically, the bill would prohibit courts from presuming the market power necessary for antitrust liability from the existence of an intellectual property right. In addition, the bill would provide that no patent owner can be denied relief for infringement because of his or her licensing practices or actions, unless such practices or actions violate antitrust laws.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Douglas Criscitello, who can be reached on 226–2850.

Sincerely,

James L. Blum,
Acting Director.

VIII. Regulatory Impact Statement

Pursuant to paragraph 11(b), Rule XXVI of the Standing Rules of the Senate, the committee, after due consideration, concludes that the bill will not have direct regulatory impact.

IX. Changes in Existing Law

In compliance with paragraph 12 of Rule XXVI of the Standing Rules of the Senate, changes in existing law made by the bill, as

reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italic; existing law in which no change is proposed is shown in roman):

UNITED STATES CODE

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TITLE 35—PATENTS

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PART III—PATENTS AND PROTECTION OF PATENT RIGHTS

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CHAPTER 28—INFRINGEMENT OF PATENTS

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Subsection 271. Infringement of Patent

(a) * * *

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(c)*(1)* Whoever sells a component of a patented machine, manufacture, combination or composition, or a material or apparatus for use in practicing a patented process, constituting a material part of the invention, knowing the same to be especially made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial noninfringing use, shall be liable as a contributory infringer.

[(d)**]** *(2)* No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his having one or more of the following: (1) derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent; (2) licensed or authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent; (3) sought to enforce his patent rights against infringment or contributory infringement.

(d) No patent owner otherwise entitled to relief for infringement or contributory infringement of a patent shall be denied relief or deemed guilty of misuse or illegal extension of the patent right by reason of his or her licensing practices or actions or inactions relating to his or her patent, unless such practices or actions or inactions, in view of the circumstances in which such practices or actions, or inactions are employed, violate the antitrust laws.

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